IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
<u>OF PREMERA BLUE CROSS AND ITS AFFILIATES</u>

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED RESPONSIVE TESTIMONY OF:

Kent S. Marquardt
Executive Vice President and Chief Financial Officer
Premera Blue Cross

April 15, 2004

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NOT FOR PUBLIC DISCLOSURE

Introduction

Q. Please state your name.

A. Kent S. Marquardt.

Q. Please identify your employer and state your title.

A. I am Executive Vice President and Chief Financial Officer of Premera Blue Cross.

Q. Are you the same Kent S. Marquardt who filed direct testimony on March 31, 2004, in this proceeding?

A. Yes.

Q. Have you read the pre-filed direct testimony filed in this matter by the witnesses of the Office of the Insurance Commissioner, the state consultants, and the interveners in this proceeding?

A. Yes, I have read that pre-filed direct testimony.

Q. Do you have a response to any of the matters set forth in that direct testimony?

A. Yes. I would like to respond to testimony on the following subjects:

- Health care expenses of non-profits and for-profits
- Differences between the Premera and CareFirst transactions
- Premera's transfer of Healthy Options and Basic Health Plans business

Health care expenses of non-profits and for-profits

Q: In their pre-filed direct testimonies, Intervener witnesses express concern that for-profit health plans pay out less of their premium dollars for health care than non-profit plans. How would you respond to this?

A. The interveners do not provide data to support that contention. Mr. Calvin Pierson cites a report[1] evaluating a potential sale of CareFirst ("CareFirst Report"), a

[1] Carl J. Schramm, BLUE CROSS CONVERSION: Policy Considerations Arising From A Sale of the Maryland Plan, November 2001

holding company of the Maryland Blue Cross Blue Shield plan. However, Mr. Pierson erroneously interprets the report to mean that, from 1997 to 2000, investor owned Blues spent 74 percent of their premiums on health care while non-profit Blues spent 84 percent. That is a misreading of the report. Contrary to what Mr. Pierson states, the CareFirst Report does not compare health care expenses to premiums. The CareFirst Report compares health care costs to total revenue, that is, premiums and other income. In the period 1997 to 2000, the same for-profit Blues spent 82.3% of premiums on medical costs, not the 74% reported by Mr. Pierson. The CareFirst Report does not support the conclusion that there is a disparity between medical spending as a percent of premiums between non-profit and for-profit Blue Plans.

Differences between the Premera and CareFirst transactions

Q: In his prefiled direct testimony, Mr. Pierson warns against the Premera conversion based on his experience with CareFirst. Please comment.

A: The proposed CareFirst and Premera transactions are very different in their structure and purpose. CareFirst proposed a conversion as part of a plan to be acquired by WellPoint, which would have resulted in a large, national insurer controlling CareFirst in its Maryland, Delaware and the District of Columbia service areas. Premera's proposal, by contrast, would allow Premera to access the capital markets in order to build its infrastructure and increase its RBC level while still remaining an independent, Washington-based company. The CareFirst proposal was also highly criticized for large bonuses that would have been paid to executives upon completion of the conversion and acquisition. By contrast, Premera committed from the outset that successful completion of the conversion would not result in any executive bonuses or success fees. Moreover, the stock plan proposed by Premera in connection with the conversion is, according to the expert testimony of Richard Furniss, more restrictive than that of other Blue plans that have converted to for-profit status. The history of CareFirst and the laws that apply to it are also materially different from that of Premera. Mr. Pierson states that CareFirst's predecessor in interest was created as a "quasi-public entity" and "an insurer of last resort." I am not in a position to comment on the accuracy of Mr. Pierson's description of CareFirst. I can say that there is no basis for his unsupported assertion that "Premera was founded in Washington along similar lines." Premera is not and never was a "quasi-public entity" or an "an insurer of last resort." Premera provides services to those individuals and groups with which it has a contractual relationship, and its revenues are payments by customers for services rendered. I also note that Mr. Pierson's experience with CareFirst can hardly be cited to demonstrate the effects of conversion in Washington or otherwise. The proposed CareFirst conversion was never completed.

<u>Premera's transfer of Healthy Options and Basic Health Plans business</u>

Q. Interveners' assert that Premera's decision to cease participation in the Healthy Options and Basic Health Plan business is connected to the conversion. How do you respond?

A. The decision to transfer Premera's Healthy Options and Basic Health Plan business to Molina Healthcare of Washington ("Molina") was not in any way connected to the conversion. Premera has evaluated its participation in the Healthy Options and Basic Health Plan programs on an ongoing basis. As early as the year 2000, Premera publicly stated its view that the Healthy Options and Basic Health Plan are under-funded and that Premera expected to exit these programs unless funding was increased. I note that Premera is not unique in this regard. Other health plans, including non-profits, have terminated their participation in particular counties or in these programs as a whole.

Q. Why did Premera decide to transfer its Healthy Options and Basic Health Plan business to Molina Healthcare of Washington at this time?

A. Molina Healthcare of Washington approached Premera in late 2003 about the possibility of transferring Premera's Healthy Options and Basic Health Plan businesses. After considering the options, Premera decided to transfer the business, in large part because Premera does not see the Healthy Options or Basic Health Plan programs as good long-term fits for the company. It takes specialized skills to administer these programs which are different than Premera's core competencies. And, as I stated previously, we are concerned that funding for these programs will not keep pace with the costs of administering them as state and federal budgets remain under tremendous pressure.

Q. Some have asserted that Premera's ceasing participation in the Healthy Options and Basic Health Plan programs will harm consumers. How do you respond?

A. Premera is transferring this business to a company that specializes in administering these types of state programs. Every one of Premera's current Healthy Options and Basic Health Plan members will have the same health care contract after the transfer that they had with Premera. Molina specializes in this business, and the Health Care Authority and the Medical Assistance Administration of the Washington State Department of Social and Health Services have approved the transfer. Consumers will not be harmed by this transfer.

Q. Does that conclude your responsive testimony?

A. Yes, it does.

VERIFICATION

I, KENT S. MARQUARDT, declare under penalty of perjury of the laws of the State of Washington that the foregoing answers are true and correct.

Dated this ____ day of April, 2004, at Mountlake Terrace, Washington.

/s/
KENT S. MARQUARDT